Filed 11/23/16 Clark v. Cunningham CA3

NOT TO BE PUBLISHED

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(El Dorado)

KRAIG CLARK et al.,	C079817
Plaintiffs and Respondents,	(Super. Ct. No. PC20150318)
v.	
JOE CUNNINGHAM et al.,	
Defendants and Appellants.	

Plaintiff Kraig Clark[1] brought this action pursuant to Corporations Code section 709 to determine the validity of the issuance of 11.5 million (rounded) shares of Renew

---

[1] In the realm of the financing of real estate, a multiplicity of involved entities seems always to prevail. In addition to plaintiff Clark, the other plaintiffs are Clark's Corner Investments, LLC, of which plaintiff Clark is the sole member, and K2R Holdings, LLC (K2R), an entity (of which Clark's Corner is the sole member and manager) that exists solely to hold shares in the defendant mortgage lender at the center of this dispute, Renew Lending, Inc. (Renew). *E pluribus unum*; we will refer only to Kraig Clark as plaintiff.

stock to an entity controlled by defendant Joe Cunningham,[2] and the proper composition of the board of directors of Renew. The trial court issued a statement of decision that voided the issuance of the shares, confirmed the number of plaintiff's shares and his majority shareholder status, directed the immediate election of five members to Renew's board, and issued a preliminary injunction against defendant from taking any actions inconsistent with its ruling. Defendant purported to appeal from the statement of decision, which is not ordinarily an appealable order or judgment; however, since it is signed and appears to be the trial court's intended final decision on the merits (and since the trial court did not enter any judgment subsequently), we will exercise our discretion to treat it as an appealable order. (*Alan v. American Honda Motor Co., Inc.* (2007) 40 Cal.4th 894, 901; *Pangilinan v. Palisoc* (2014) 227 Cal.App.4th 765, 769.) We shall affirm the order.

FACTUAL AND PROCEDURAL BACKGROUND

The parties do not identify any errors in the trial court's summary of the pertinent facts. We therefore quote from it, with some additions.

"The facts, although somewhat complicated, are not in material dispute. [Renew] is a regulated lender of residential mortgages. At all times relevant[,] Joe Cunningham, Jr.[,] was the CEO . . . . Renew operate[s] in four . . . western states and has 75 employees." Defendant held 13.3 percent of Renew's stock in March 2015, and R2L held 21.2 percent. "The business of Renew is not capital efficient, and it operated with serious capital def[ici]encies. Plaintiff Kraig Clark . . . was approached in 2013 to act as

---

[2] The cast of defendants also includes R2L Holdings, LLC (R2L), a stockholder of Renew of which defendant Cunningham is the sole manager; Cole Woolsey, a minor shareholder and former Renew board member; C2W Holdings, LLC (C2W), of which defendant Cunningham is the manager, and which is the transferee of the shares of stock at issue; and Kathy Cunningham, defendant Cunningham's wife, whose status as a new Renew board member is also at issue. Again, we will refer only to Joe Cunningham as defendant.

an investor. . . . Plaintiff invested [$2 million]. A subscription offer accompanied this investment. Although dated December . . . 2013, the transaction actually occurred in 2014," with plaintiff depositing the funds in March. As a result, plaintiff held 49 percent of Renew's stock through K2R. "In addition to the subscription offer, a Rights Agreement, of the same date, was executed. By any measure, that agreement was unwise." (The trial court did not elaborate.) "It granted [plaintiff] the right to appoint two . . . board members" once Renew exercised its power to expand its board from three to five members "and reserved an option for Renew to reduce the equity position of Clark [to 24.5 percent] upon payment of an inflated price [for the shares, which would reach $9 million in 2016 before it expired at the end of that year]. Despite language stating [that] a formal agreement would follow, nothing happened." Later, after lending Renew an additional $203,130, the loan "was converted to equity under a subscription agreement dated October . . . 2014.[3]" As a result, plaintiff controlled 51.4 percent of Renew's stock.

"Despite the capital infusion by [plaintiff], even more cash was necessary, in part to pay unpaid IRS withholdings for the first quarter [of] 2015 and fourth quarter of 2014, together with additional sums to cover expenses. [Defendant] proposed that [plaintiff] invest another $600,000.00. A meeting was scheduled for May 8, 2015. At that date the following facts were true: (1) [Plaintiff] was the majority shareholder; (2) Despite the requirement to do so, Renew had not issued any share certificates to [plaintiff];" (although a list of shares that defendant provided reflected plaintiff's holdings, and plaintiff was paid dividends from the date of the subscription agreement); "and (3) Despite [his] prior requests . . . , no board of directors meeting or shareholder meeting

---

[3] "[K2R] was formed to hold shares to be issued under these deals[;] [defendant] was [its] manager."

had occurred and therefore [plaintiff] could not exercise his request to appoint two . . . directors.

"To put it simply, the meeting of May 8, 2015[,] failed. No investment occurred. [Plaintiff] insisted upon [the] resignation of [defendant] and his associate[, Cole] Woolsey. [Defendant] believed [plaintiff] was attempting a hostile take-over of Renew. (Of course, [plaintiff] then *was* the majority shareholder.) [Italics added.]

"On May 13, 2015, [defendant] and Woolsey, as the only two . . . [existing] directors [(the third director having resigned earlier in the year)] appointed [defendant]'s wife[,] Kathy, as the third director. Article 3.5 of the [Bylaws] allows appointment to fill a director vacancy by a majority of the remaining directors. Of course, there is no evidence of any notice of the meeting of the [board] being given. ([M]ore on that general topic later.)"

Renew and defendant did not exercise their right to repurchase plaintiff's shares under the Rights Agreement. Rather, "[o]n May 13, 2015[,] Renew decided to enter into two separate transactions, each of which was specifically intended to frustrate the rights of [plaintiff] (actually [K2R]) as the then majority shareholder. A subscription offer, dated May 14, 2015, reflected acquisition of [10 million] shares for [$1 million]. The subscriber[, C2W], was co-managed by [defendant] and Woolsey. It also was formed on May 13, 2015. No consideration was received by Renew on May 13, 2015, or later. The next day, a second subscription agreement was entered into between Renew and [C2W.] The consideration for this was [the alleged] cancellation of certain loans made by the Woolsey family to Renew totaling" $150,000 in exchange for 1.5 million shares (both figures rounded).

"It is necessary at this point to comment upon the utter lack of corporate formalities. There is no question that Renew and its principals are heavily regulated by agencies of the Federal Government. Indeed, part of the creation of [K2R] was a desire to shield [plaintiff] from the vetting process required of [defendant] to qualify to issue loans. All this said, despite the multiple subscription offers discussed here, there is no evidence that any shares were issued. No shareholder meetings have occurred since [plaintiff]'s investment of [$2 million]. To the extent that debt was converted into equity, there is no evidence of any notes being cancelled."

When it became clear to plaintiff that defendant would not be complying with the demand that he resign as a condition of further investment, "[plaintiff] removed [defendant] as manager of [K2R]. On May 20, 2015, [plaintiff] caused, based upon his belief that he was still the majority shareholder, the preparation of 'action by written consent of shareholders.' That notice reflected the appointment of himself and another as directors and expanded the maximum [number of directors] of Renew to five." The new directors sent notice of a special board meeting to defendant, who responded with the documentation of the actions taken on May 13 and 14. Plaintiff sent a request to the Renew board for a shareholders meeting in July 2015 to consider the removal and election of directors, and then filed this action in June 2015.

The trial court concluded the May 2015 subscription agreements to be a sham, intended to frustrate the rights that plaintiff held under the Rights Agreement in violation of the covenant of good faith and fair dealing, which protected plaintiff from dilution of his ownership percentage of the corporation. It rescinded them as void, and directed the occurrence of a shareholder meeting as soon as permissible under the bylaws in order to elect five directors.

DISCUSSION

Defendant correctly points out that while the Rights Agreement provides a method for the repurchase of plaintiff's shares (this agreement does *not* expressly state that this is the *only* method by which plaintiff's ownership percentage can be reduced, as plaintiff repeatedly suggests), neither that agreement nor the two subscription agreements with plaintiff offered any express right against dilution of plaintiff's ownership percentage. Defendant then proceeds to discuss straw issues relating to the covenant of good faith and fair dealing (e.g., the principle that it cannot impose an implied term contrary to the express terms of a contract, and the absence of any allegations in the complaint regarding a breach of this covenant), and the absence of any protection in general corporation law against dilution of an ownership percentage. We agree that the trial court's invocation of the covenant in this respect is not apt, given the absence of any express dilution protection, but it is ultimately immaterial to the point of its holding that the stock transactions with defendant C2W were a sham to deprive plaintiff of his then existing rights to have Renew increase the size of its board and allow him to elect two of the directors. This *is* a classic violation of the covenant of good faith and fair dealing: engaging in conduct that frustrates the other party's rights to the benefits under an agreement (*Carma Developers* (*Cal.*)*, Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 373). However, the existence of a breach of this covenant does not add anything to the analysis of the sham nature of the transactions, so we do not need to consider the issue any further.

With respect to the finding that the shares issued to C2W are void, defendant asserts plaintiff should be equitably estopped from making this claim because the two transactions were structured in the same manner as plaintiff's two subscriptions, in which he obtained immediate status as a stockholder even though he did not provide the funds until three months later and also converted a loan to stock without an accompanying documentation of the express cancellation of any note. Assuming that defendant has not forfeited this issue, which he did not expressly raise in the trial court, it is not well taken. In finding the C2W stock void, the trial court necessarily concluded that defendant did not have an intent to fund the transactions (at least as of the date of the ruling), unlike plaintiff, and therefore the doctrine of equitable estoppel does not have any application to transactions that are different on this material point.

On the substantive merits of the trial court's ruling, defendant does not have any argument. Shares must be issued in exchange for money paid, labor done, property or services actually received, or debts actually cancelled, otherwise they are void. The mere promise to pay does not constitute payment. (*Clark v. Millsap* (1926) 197 Cal. 765, 779; Corp. Code, § 409, subd. (a)(1).) The trial court therefore properly voided the shares issued to C2W, and ordered the election of new directors at a shareholder meeting.

DISPOSITION

The trial court's order is affirmed. Plaintiff shall recover his costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1), (2).)

BUTZ, J.

We concur:

HULL, Acting P. J.

MAURO, J.